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UNCLAS SECTION 01 OF 02 TAIPEI 004178

SIPDIS

STATE PLEASE PASS AIT/W AND USTR

STATE FOR EAP/TC, EAP/EP

USTR FOR WINTER AND WINELAND

USDOC FOR 4420/USFCS/OCEA/EAP/LDROKER
USDOC FOR 3132/USFCS/OIO/EAP/ADAVENPORT
TREASURY FOR OASIA/LMOGHTADER
TREASURY PLEASE PASS TO OCC/AMCMAHON
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN

SENSITIVE

E.O. 12958: N/A

TAGS: [EINV](#) [EFIN](#) [ECON](#) [PINR](#) [TW](#)

SUBJECT: Taiwan's Cash Cards

SUMMARY

1. Cash card debt write-offs by Taiwan banks have increased sharply since June of this year mainly due to card-issuing banks trying hard to live up to a new, stricter non-performing loan (NPL) definition. Some observers worry that the sharp increase in cash card cancellations could create a credit crunch that could dampen Taiwan's private consumption and economic growth. Meanwhile, the value of loans to cash card accounts continues to grow rapidly. END SUMMARY.

What are Cash Cards?

2. In addition to credit and debit cards, many Taiwan banks offer "cash card" arrangements under which consumers borrow money from the bank at an interest rate much lower than that offered on credit cards and agree to make set monthly payments to the bank to repay the loan. The cash card provides access to the borrowed money at ATMs and at most places that accept credit cards. For Cosmos Bank Taiwan, the largest issuer with a 25 percent market share, the cash card business contributes over 60 percent of the bank's net profits. However, a recent Fitch ratings report indicated that many Taiwan cash and credit card lenders are losing money because of their high operating costs, small client base, and poor risk management.

New Definition for NPL

3. In July this year, Taiwan's Financial Supervisory Commission (FSC) adopted a new policy that defines NPLs as loans overdue three months or more. Prior to July 1, a loan was non-performing if no principal or interest payments had been made for six months.

Sharp Increase in Write-offs

4. The change in the NPL definition, together with strong FSC pressure on banks to keep their NPL ratio below three percent, has forced cash-card issuers to write off large amounts of bad debt beginning mid-2005. Write-offs in May 2005 posted a moderate growth of 4% from a year ago to NT\$877 million. The growth in subsequent months shot up to 189% in June, 112% in July, and 210% in August.

5. Under the old NPL definition, no cash-card issuers posted cash card NPL ratios above the FSC-set 3% limit in June 2005. However, after the change in overdue policy, five banks were penalized for crossing the 3% limit in July. In August, the number of banks violating the 3% NPL ratio limit declined to three.

Credit Crunch?

6. In recent reports, foreign financial analysts have expressed concern that the new FSC policy could contribute to banks being less willing to offer consumer credit and that, in turn, could dampen private consumption and economic growth. The "Financial Times" recently reported that the lack of credit growth "is pushing" Taiwan into a credit crunch of the sort suffered by South Korea in 2002-3.

7. In spite of the Financial Times article, most local

observers believe the background of South Korea's 2002-3 credit crises was much different from Taiwan's current situation. By writing-off bad debt, Taiwan banks have been able to continue to expand their cash-card services. Revolving balances of cash-card accounts grew 53.5% in July and 50.3% in August.

18. Our FSC contact told AIT that the rapid growth of cash card accounts reflected the handsome profits originating from cash card services, and that the large volume of write-offs represented Taiwan banks' sufficient profitability to deal with bad debts. The FSC contact stressed that outstanding loans offered by banks to cash card holders remained relatively small and unlikely to seriously impact overall spending. He noted that cumulative lending to cash card holders as of August 2005 was only NT\$312 billion, less than two percent of total bank loans (NT\$16.5 trillion).

PAAL